RICHARD RUSSELL'S DOW THEORY LETTERS INCORPORATED

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Dec. 30, 1998 **LETTER 1268**

THE PICTURE: Talk is talk (and I do a lot of it), but price action is "where it's happening." When all the talk and predictions and hopes and wishes are expended, it's price action that gives us our profits or losses.

The last few weeks of December possess a strong seasonal bullish bias. Evidently, no matter what happened during the year, there is something about the last two weeks of the year that generates optimism among investors. If the past year has been a rotten year, investors tend to believe that "next year will be better." If the past year was a great year, investors normally believe "the new year will be even better." It's human nature to be optimistic -- particularly, it seems, during the last two weeks of December.

I named this service Dow Theory Letters for a reason. The reason is that I preach Dow Theory. This being the case, let's examine the market picture on the basis of the time-tested tenets of Dow Theory. The most fundamental Dow Theory thesis is that **over the long term values determine the trend of stocks.** The Dow Theory utilizes the D-J Industrial and Transportation Averages to **identify** the market trend.

But neither the Dow Theory nor any other theory can predict market direction over the very near term. Over the near term, "the market can do anything." Again, over the long term, values will out (and yeah, I know, Keynes said that "over the long term we are all dead," but Keynes was just being facetious -- over the long term Dow Theory does work).

I developed my Primary Trend Index (PTI) because of a definite need; that need was to track the actual or current trend of the market regardless of values or money flows or opinions or anything else. For **traders,** the PTI is the best tool I've ever come across for that purpose. For **long term investors,** however, I advocate Dow Theory. It's the system for patient investors; it's the system for those who buy values at or near the bottom and who sell values at or near the top.

Currently, on any historical test of values, stocks are **expensive.** The Dow is now selling at 24.8 times trailing earnings, while yielding a minuscule 1.6%. On top of that, the Dow is selling at over five times book value. On the basis of values alone, no orthodox Dow Theorist would touch this market.

PRICE ACTION: The chart on this page show the two D-J Averages, Industrials and Transports. The Industrials have clearly been much stronger than the Transports. Note that the bull market high for the Transports was recorded back eight months ago on April 16 at **3686.02** with the Dow at **9076.04.** A decline ensued, then a rally, and three months later (in July) a second (record) high for Industrials was struck at **9337.97.** As you can see, this second Dow high was not confirmed by the Transports. The result was the sudden violent collapse to the September-October lows.

From there the market headed up again, and on November 23 the Dow hit a third record Dow high of **9374.27.** Again the Transports refused to confirm. Following this non-confirmation stocks turned ragged -- but as the market moved into the historically bullish final few weeks of December, the Averages pushed higher again with the S&P and Nasdaq hitting new highs.

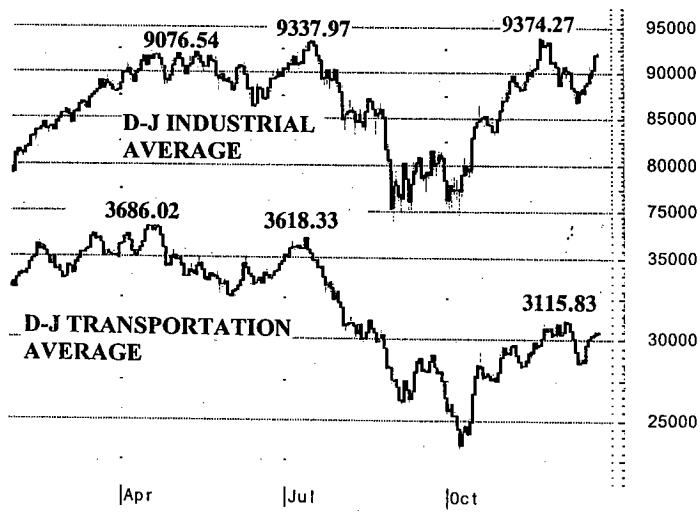
Dec. 18 DJIA 8903.63; PTI 5344; A-D Ratio +4.89
Dec. 24 DJIA 9217.90; PTI 5356; A-D Ratio +5.15
Dow Yield: 1.65%; Dow Price/Earnings: 24.0
Dow 144-day MA: 8652; Dow 34-day MA: 8934
Dow Times Book Value: 5.78; PTI 89-day MA: 5316
Percentage of Undervalued Blue-chips: 4%
Gold 34-day MA: 294

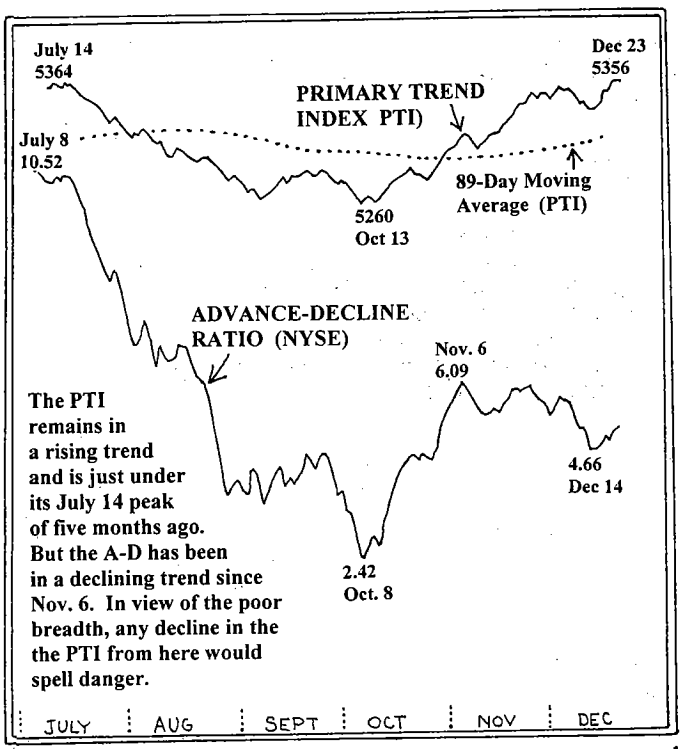
So to make it simple, in Dow Theory terms, here's what we have. We have two successive record high peaks in the Dow accompanied by two successively lower peaks (non-confirmations) by the Transports. On top of that, we have the most over-priced stock market in history. From a Dow Theory standpoint, the market could not be more dangerous. From the public's standpoint, it's a marvelous, ever-rising market, and they're buying it hand- over-fist.

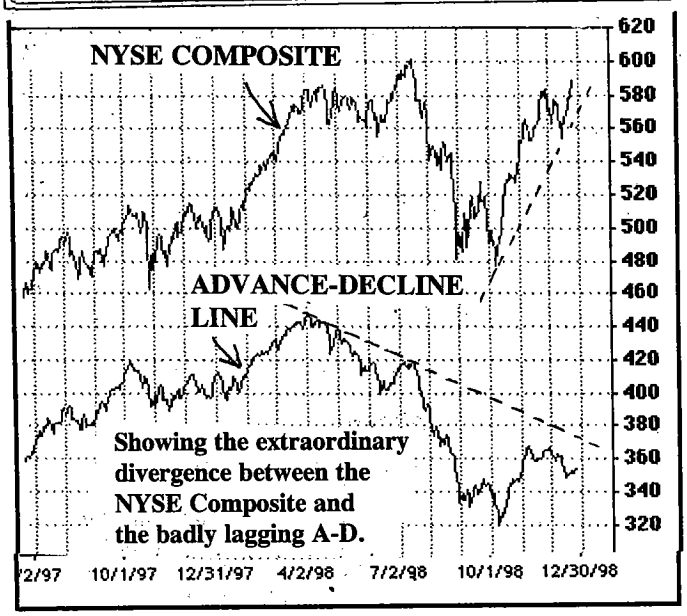
That's the big picture as we enter the new year 1999. But let me add a couple of observations. I suggest watching the action of the Transports. The Transports have been a major technical problem under Dow Theory. Could the Transports finally confirm? I doubt that that's going to happen, but as I said, "the market can do anything." The first indication of real Transport strength would be the Transportation Average moving above their preceding secondary 3115.83 level of December 7.

PTI and BREADTH: (page 2 chart). I've often stated that to read the **PTI** "all you have to know is up from down." The PTI continues to hold well above its 89-day moving average. As a matter of fact, the PTI is now within a few points of its mid-July record high of 5364. I'll continue to grade the PTI **bullish** as long as it holds above its MA. Nothing complicated about that -- trend of the PTI is up.

The **advance-decline ratio** is quite another story. I include a second chart on page 2, courtesy of *Decision Point* off the Internet. Here we see the NYSE Composite (which is not yet at a new high) and the A-D. The A-D advance during October-November has been one of the weakest I've ever seen in the face of a strong rally in the major averages. On the October-November market rally the A-D recouped only one-third of its bear market losses. Worse, since November 6, despite rising stock averages, the trend of the A-D actually has been down. Conclusion-- dangerous price/breadth divergence.







COMMENTS: People who don't understand or who don't believe in the Dow Theory are almost unanimous in stating that the "bear market ended at the August-October lows." I disagree -- I do **not** believe that the bear market ended at the August-October lows.

What we saw on the violent October-December advance was new highs in the big-cap averages such as the Dow and the S&P 500. However, we saw failures-to-confirm on the part of the broad NYSE Composite, the very broad Wilshire 5000, the Value Line Composite, the D-J Transportation and the D-J Utility Averages, the Russell 2000 and the advance-decline ratio.

The S&P 500 has been dramatically stronger than the Dow over recent months. The reason -- almost frantic buying in a very narrow number of Internet-related stocks: Intel, Microsoft, Dell, Cisco, Sun Microsystems, Worldcom. Now this is important--of the 30 Dow Industrial stocks, not one (surprisingly) possesses a *major* involvement with the Internet. Item: only 10 stocks have been responsible for 46% of the advance to new highs in the S&P, again indicating narrow breadth.

So it's clear, the stock market is saying (and admittedly it's very early) that if you're involved with the Internet you're part of the future; if you're not involved with the Internet you may be OK, but you're not "where it's happening." And, of course, the great majority of US corporations are not involved with the Internet. By the same token, the majority of US stocks have either lagged on the October-December rally or they have not participated at all.

Question: Can the net stocks continue to "fire up" the entire market? Can the net stocks hold back the bear? So far, this almost appears to be what's happening. But no, I don't think the net stocks alone can hold back, much less reverse, the primary trend of the market. But no doubt about it, the net stocks have captured the imagination of both Wall Street and the public.

I mull over this picture, and I've talked about this before. If the booming net stocks are the wave of the future, then what will happen to the rest of the US corporations? Won't the average retail store and the great American middle man be the losers, along with a lot of other industries? With the arrival of the Internet, aren't we watching "the death of a salesman?" The explosion in the net stocks seems to be telling us that we're on the edge of a revolution -- but most people and most industries either aren't part of it, or they simply aren't prepared for it.

Consider this: If you're a major bank and you have 500 branches, each branch servicing customers in a specific area, what do you really need all those stores and all those employees for -- when you could get it all done on the net with only 20% of your current employees. And as for those 500 banks and all that expensive real estate, you don't need it; it's just tying up capital. Close them, sell them -- they're an unneeded expense, just like 80% of your current employees. That's what the Internet will eventually mean to corporations all over the US and the globe. The net -- "by its nature, hostile to profits -- and jobs."

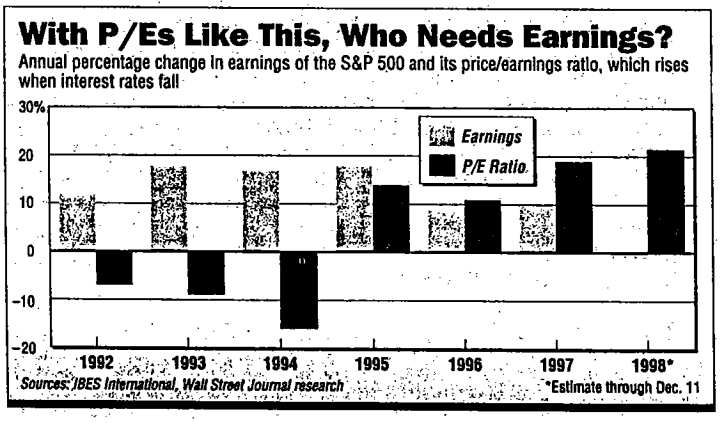
SERIES: One of the statements you now hear from analysts is that "since 1939 (1939 was a year when international war clouds were forming) we've never had a down year in a pre-presidential election year." That historical fact would seem to almost guarantee a rising market during 1999.

However, there are two items to consider here. **(1)** The longer a series continues, the better the chance that the series will be coming to an end. For instance, a recent example is the stunning series of Super Bowl wins by the National Football League. It seemed as if the American League would never win a Super Bowl. Flip a coin and maybe you'll get a stunning series of eight heads in a row. Of course, each time you toss the coin there is a 50/50 chance that you'll throw another head. But the laws of chance suggest that this will eventually end.

(2) A primary bear market is now in force. The fact of a bear market will definitely affect the odds that 1999 will be "just another pre-presidential up-year." Consider this -- 1931 and 1939 were both pre-presidential election years and they were both down-years. Why? Because in both cases bear markets were in force.

EARNINGS, INTEREST RATES: There's no question, as the *WSJ* (Dec. 14) put it, with the trend of corporate earnings now declining, interest rates have been the driving force behind the stock market. The chart (top of page 3) illustrates dramatically what is happening. Earnings, up to now, have been adjusting for interest rates. Since declining interest rates increase the value of earnings, the result has been **rising price/earnings ratios.**

Of course, all this could (and will) change during a bear market. Declining interest rates can't save a market in which earnings are steadily declining. For instance, during the 1930s T-bill rates sank below 1%, but even those "give-away" rates failed to do much for the stock market. Again, we have the current example



of Japan where rates are almost at zero and yet the Nikkei stock average remains better than 60% below its 1989 high.

In a bull market, where earnings are in a rising trend, declining interest rates provide an added bullish stimulant and the price/earnings ratios will work higher. But in a primary bear market in which the trend of earnings is persistently down, declining interest rates may not work as a stimulant. As stated, this was the case in the US during the '30s, and it has been the case in Japan ever since 1989.

Currently, earnings are continually being adjusted downward (see *Barron's* weekly adjustments in earnings in both the Dow and the S&P). Yet investors continue to apply declining interest rates to these declining earnings -- the result giving us the highest price/earnings ratios in the history of Wall Street.

Conclusion: If I am correct, if we are, indeed, in the early part of a primary bear market, then somewhere ahead the market will recognize that the decline in corporate earnings is fated to continue. At that point, with P/E ratios still at record high levels, the stock market is going to find itself in extreme danger. That juncture will probably occur sometime in 1999.

For some reason, this whole period in the stock market reminds me a lot of 1968. At that time Wall Street and the public went wild over biotech stocks. The sentiment was that "it's a new world" and no price is too high for the new tech stocks, stocks that were fated to change the world as we knew it. The Amex was booming, Nixon was elected in November, speculation grew extremely heavy, and by November the Dow had rallied to 985.21, only 10 points from its previous all-time high. In early '69 breadth turned decisively down, even though the Averages were fluctuating wildly. Transports began to collapse in February; they were joined by the Dow in May. After May the broad market headed sharply lower, and by December the market was in shambles. In less than a year, the hysteria of late-1968 had become the gloom of late-1969. Wall Street and the public were in shock. The great biotech boom had ended.

The following is a very revealing piece from the December 19 London *Financial Times* (and by the way, I find the reporting in the *FT* much more objective than the "starry-eyed" and ever-bullish reporting seen in most US publications). *"The US stock market is preventing global recession. If US consumers are to continue spending with vigor, equities may have to rise to yet more dizzying heights. This is frighteningly reminiscent of the political economy of the Japanese bubble of the late 1980s, on a global scale. For Alan Greenspan's Federal Reserve it also creates horrible dilemmas. . . . Unfortunately, the US current account deficit cannot continue at 3% of GDP indefinitely. Moreover, with equity markets fully recovered from the turbulence of August and September, valuations are once more at unprecedented levels...What lies behind the high prices of US equities? . . A big part must be the conviction that they are underwritten by the Fed in order to sustain the expansion in domestic demand."*

INVESTMENT POSITION: According to Dow Theory, a bear market was signaled on August 4. That was the day when the plunging Industrial Average confirmed the prior bearish penetration of the Transportation Average. More than four months have now elapsed since August 4, and the **Dow Theory bear signal has not been rescinded.** Consequently, the bear remains in the box.

The old adage runs, "When everybody is thinking the same, nobody is thinking." This may explain what's happening in the stock market as it surges higher and as dividend yields grow progressively thinner. The latest dividend yield for the widely-followed S&P 500 is 1.21%. This means that stock-buyers are paying a record 82 dollars for every one dollar of S&P dividends. The buyers of a Treasury bond will receive roughly **four times** that amount in annual interest (and the bond's interest will be free of state taxes). As a matter of fact, that four-to-one ratio in favor of bonds is the same ratio that existed just prior to the 1987 crash.

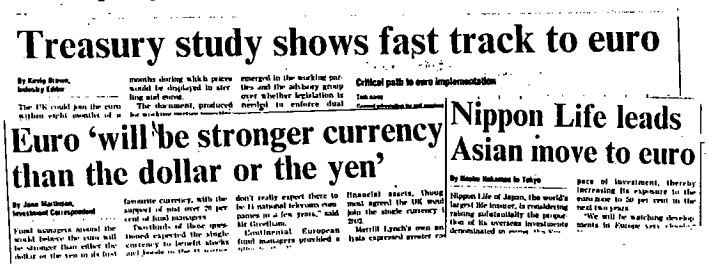
What are the buyers of stocks thinking? They have to be thinking that the future is "capital gains forever." They must be thinking that way because they're certainly receiving no yield from stocks. All a stock-buyer can hope for is that stocks, now at their highest valuations in history, will continue to push ever-higher.

Any seasoned investor, anyone who understands **risk,** will not touch this market. They will watch it, they will marvel at it, they will keep their TV sets turned to MSNBC, they will continue to read the *NY Times* and the *WSJ,* but they won't put their hard-earned (or even easily-earned) money into this market. They won't buy this market because there's **no return on the investment.** There is only the hope that upward momentum will continue. There is only the hope that value will continued to be ignored. But that isn't enough for the seasoned investor. Believe me, it just isn't enough.

For income and particularly for safety, my instinct is to stay pretty **short** here. That means T-bills from 91-days maturity to about one year. I say this because I don't care for the recent action of the bonds, and I particularly don't like the action of the Eurodollars, which are on the edge of turning bearish. (Eurodollars are large dollar deposits in Europe which are very sensitive to international sentiment. The Euros often lead rates on Fed Funds.)

NOTES & QUOTES: On January 1 the **US dollar** will have its first serious competition in 70 years. **That competition is the euro.** Currently, because of the strength in the stock market and the US economy, Americans are confident of just about everything including continuing strength in the dollar. I quote from an article in the Dec. 17 *USA Today* -- this is my friend, Jim Grant talking: "The big event now is the imminent loss of the dollar's status as the one and only reserve currency in the world. The dollar for a couple of generations has been the Coca Cola of monetary brands. It's been the only brand that's dominated vault space in central banks. It has been the transaction currency of choice. The yen, the D-mark and Swiss franc have been only marginal competitors. Now there is the euro. All at once the world has an alternative. If the world is sick and tired of being lectured by functionaries from the US Treasury Dept., or if the world reasons South America is going to blow up or that the US economy is going to weaken or the US bull market is going to slacken, the world may now diversify into euros."

Russell Comment: And I'll add this -- the world could also be getting tired of trading its merchandise and raw materials for US paper, paper which costs us nothing, paper which is manufactured at the pleasure of the Fed. To me, the dollar could be the Achilles Heel of the US economy and the US stock market. If there is to be massive "diversification" out of dollars and into euros, if the dollar slides dramatically, there will be trouble aplenty.



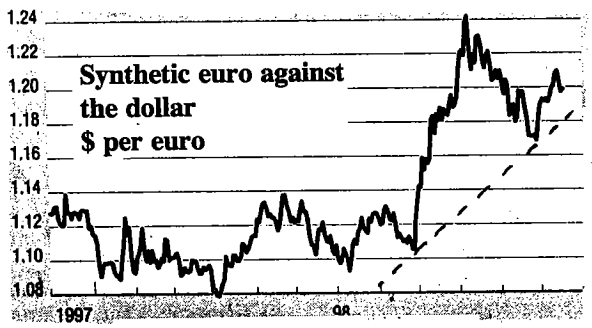
Treasury study shows fast track to euro

Euro 'will be stronger currency than the dollar or the yen'

Nippon Life leads Asian move to euro

Critical path to euro implementation

I seem to be the only service talking about the dollar/euro trend -- but here's the story (chart courtesy of London's *Financial Times).* Looking at the chart, we see that the euro bottomed at 1.08 in mid-1997, moved sideways during the first part of '98, then spiked up to 1.24 to the dollar. The euro corrected to 1.17, but most recently the euro has been creeping up again, the latest price being about 1.21. The euro is now considerably stronger than the dollar. If the euro climbs back to 1.24 or breaks out above 1.24 -- there could be a scramble out of dollars and into euros. In which case -- watch out.



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I've read a car-load of interesting stories about Y2K, but I think this is the best I've come across--it's an article which appeared in the January issue of *Scientific American.* It was written by Peter de Jager,a technology consultant whose essay, "Doomsday 2000,"published more than five years ago in Computerworld, is widely credited with alerting the industry and governments to Y2K. De Jager is currently special adviser to the UK's Year 2000 Task Force. Here's how the article ends: *"I believe that severe disruptions will occur and that they will last perhaps about a month. Additional problems, ranging from annoyances to more serious issues, will continue cropping up throughout 2000. This prediction may be optimistic; it assumes that people will have done what is necessary to minimize the number of single points of failure that could occur. Accomplishing that alone in the time remaining will require a Herculean effort unprecedented in the history of computers."*

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"Internet Stock Report" by Steve Harmon (on the net) has been incredibly good at predicting the future of the net and the companies involved with the net. Harmon writes that Intel, Hewlett-Packard, Oracle and IBM "may be the real long-term losers for not having snatched up Netscape while they had the chance. Even at 50% browser share, Netscape is still a platform for launching anything Internet. These firms missed their chance to take their firms front and center on the Web. None of them have significant Web presence -- the equivalent of not having a doorway to tomorrow." **Russell Comment:** I believe Harmon is right, and of the 30 Dow Industrials, none have a real Internet involvement (the two which should are IBM and HP).

James J. Creamer, principle of The Street.com web station (this guy is everywhere), writes, "The state of the brokerage industry has never been more tenuous than right now. The whole industry is being torn asunder by low commission, indifferent research and a sense of no value added. Neither the companies that the industry promotes nor the customer himself is happy with the service or input that traditional brokerage presents. And the source of all of the turmoil is none other than the Internet itself." **Russell Comment:** For the life of me, I don't see how the old-line brokers are going to survive if they don't offer online brokerage. But the mark-up on online brokerage is minimal and the competition is fierce. Watch for mergers and big changes on Wall Street.

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The Asian recession/depression is hitting diamond sales -- hard. DeBeers, by far the leading company in the diamond industry, sells its diamonds via its CSO, or Central Selling Organization (diamonds are sold to dealers in the "rough," or before the diamonds are cut and polished). Industry predicts that the CSO will post a 27% drop in diamond sales to $3.4 billion, lowest sales since 1987. This does not mean that the retail price of diamonds must fall. DeBeers usually buys up and holds any overage of diamonds and at the same time cuts back on sales of rough to dealers. Remember, big stones (over 5 carats) are rare, small stones (under one carat) are not.

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Mutual fund inflows are declining. The recent three-month total sank to the lowest level in more than eight years. If this trend continues, one of the mainstays of market strength will be dissipating.

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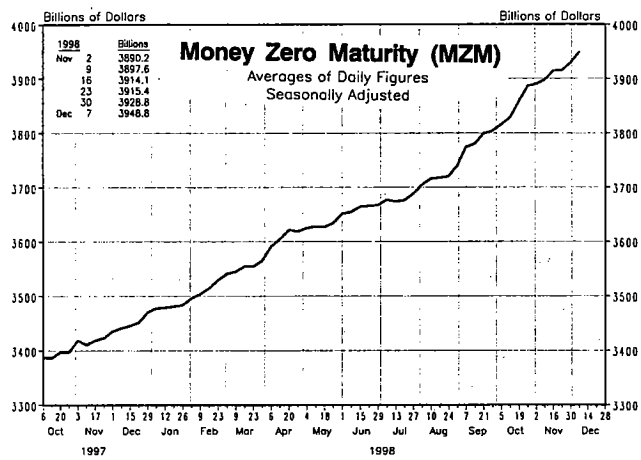
The US money supply continues to soar unabated. To me, this speaks of what must be a state of near-panic on the part of the Fed. The Fed simply cannot allow the bear market to express itself, lest consumers and stockholders panic. This chart (courtesy of the St. Louis Fed) shows MZM (money of zero maturity or money that is instantly spendable) rising at a furious rate. In the most recent weeks, MZM has been rising at an annualized rate of above 20%. My feeling is that as long as gold stays below 306 or in that vicinity, the Fed will allow the money supply to balloon higher.



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The following from Ed Hyman's *ISI*: "A wave of deflation is sweeping Asia that seems likely to hit the G7 shores with floods of discounted goods. Prices are clearly deflating in Asia -- Hong Kong's CPI has declined at a minus 8.2% annual rate over the past three months. Salary cuts are sweeping the region. The HK government is encouraging workers to accepts cuts. Singapore has announced a national cost-cutting plan aimed at slashing overall labor costs by a stunning 7% of GDP. . . . We have counted 22 central banks easing in November, bringing the October-November total to 40!" **Russell Comment:** Asia is in a state of near-depression. Social problems often give way to political problems. Thus, we read increasingly of students and workers clashing with police or with politicians.

People are wondering who's doing the great public relations number on Hillary (she of the $100,000 profit in cattle futures). Despised by many a few years ago, suddenly Hillary has become America's darling. Writes Hollywood columnist Liz Smith, "As we hurtle towards 1999, the big question in media circles is who is the PR mastermind behind the glamorization and dramatization and dynamic new presentation of Hillary Rodham Clinton. The *Vogue* cover, the many public appearances, the cozying up to Miramax and Harvey Weinstein, the explosive potential of the *Time* magazine cover as the Person of the Year. Who is the genius behind it all? . . .Mrs. Clinton is a survivor. The iceberg has struck, but she's on the life raft." **Russell Comment:** I continue to believe that Hillary is going to dump Bill at the end of his term (or whenever his journey at the White House ends). It's clear to me that Hillary is preparing for a political life of her own. Maybe as a Senator or even a Vice President on a Gore ticket. Rest assured, I won't be voting for her. Maureen Dowd's (*NY Times* op-ed columnist) latest description of our President: *"I mused how odd it was that a President who seemed so cuddly and eager to please had ended up creating such chaos. There' something about him -- maybe the feeling that he's always getting away with something -- that drives people crazy. In Washington we refer to this polarizing effect as 'Clinton poisoning'. He drove Ken Starr crazy. He drove the Republicans crazy. He drove the pundits crazy. He drove his staff crazy. He drove the country crazy. . . But I still feel sorry for the guy. He must drive himself crazy too."* **Russell Comment:** I agree with Dowd. And in a way, I think Clinton is crazy; he's a zany on a merry-go-round, a mass of drive and ambition and manipulation and survival instinct -- without a center, without shame, without a sense of self.

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The biggest killer in America is heart disease. And, statistically, there's a fair chance that you'll be dealing with it. So let's talk about it (I've had a bit of experience in this area, since I've had two heart attacks, a quadruple bypass and a "stent" put in one of the grafts that closed 10 years after the bypass). The well-known Dr. Dean Ornish has shown that by following a strict regimen he can actually reverse plaque build-up in many of his patients. Ornish's regimen is difficult to follow and it's much stricter than what the American Heart Association advocates. The AHA suggests exercise plus a fat intake of less than 30%, saturated fat less than 7%, carbohydrates of 55% or more and less than 200 milligrams of cholesterol. Ornish advocates daily exercise, a vegetarian diet, a support-group environment, meditation and the following: total fat intake of 10% or less, almost NO saturated fat, only 15% to 20% of protein and a tiny 5 milligrams of cholesterol. Also no alcohol, drugs or tobacco.

After five years many of the Ornish group on his strict regimen showed actual improvement in their blood vessels. The AHA control group did not. However, I maintain that the Ornish regimen is so strict that the average person cannot stick to it -- even if his life is on the line. I do think people can cut out tobacco and a LOT of their fat intake, and they can do plenty of exercise. But that may not be enough.

When I had my bypass the good surgeon told me that after about 10 years many of his patients (with their arteries stopped up again) come back for a second bypass. Well, it's been 13 years since my bypass, and I now go 35-40 minutes on a tread mill daily with no problems at all except a bit of perspiration. Also the angina (chest pains) I used to suffer from have about disappeared. To what do I ascribe my continued (actually improving) good health? **Chelation,** the process no cardiologist or surgeon wants to talk about. I'm not going to go into my usual long diatribe about the "wonders" of chelation. Suffice it to say that I believe chelation works in clearing out blood vessels. In fact, I'm convinced that it works. So here's what I suggest. If you have the faintest suspicion that you have potential "heart trouble," get on the Internet and punch out WWW.chelation.com. Read it and you decide. That paragraph, if you take it seriously, may be the most important paragraph you'll ever read. Period.

Speaking of the net, as most of you know, a "portal" is a web station or actually a directory (rather than a search engine). The portals, unlike search engines, are created by human beings. In other words, people who run the portals go through and assign certain information to categories. The best known portals are Yahoo and AOL. These portals employ search engines to do the groundwork, and the portals then organize the material in what they believe are convenient forms. For instance, if you want to learn about poodles, you can hit Yahoo and you may get five or 10 different web sites which tell you about poodles. But if you hit Alta Vista, a very powerful search engine, you may get 1,500 items on poodles, many of which you can't use. In other words, the mass of material is not organized. Some search engines you may not know about are Alta Vista, Ask Jeeves, Excite, GoTo, HotBot, Inktomi, Infoseek, LookSmart, Lycos. By the way, the portals make their money through advertisers, who often pay the portals based on how many times their web site is hit. I gather the search engines are paid by the portals, although some portals own their own search engines (such as Netscape). By the way, here's a new Internet stock that's rumored to be coming out soon -- it's called Tulip.com.

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I've owned all kinds of dogs -- bull terriers, mastiffs, great danes. A year ago we inherited a standard (large) apricot poodle from my mother-in-law. I liked the big female poodle so much that a few weeks ago I bought her a companion, a two-year-old black standard male. Three days after I got the new dog, "Randall" escaped through a hole in my fence. That day a woman called me in a near-hysterical state. She told me she had hit the dog with her car, the dog got up and was hit by a second car, whereupon the dog got up and ran away. She had no idea where he was. That was Thursday. I spent a whole weekend looking for that dog. I had put a tag on his collar with my name, my telephone number and the single word, "reward." On Sunday a fellow called me from a parking lot 14 miles to the south. He said he had the dog, and would hold it for us. We drove down to see the fellow. He was a down-and-outer living on the beach out of his van. The dog was Randall, and I gave the fellow a hundred dollar reward (he almost passed out in shock). We were over-joyed to find Randall again; he had not eaten or drunk water as far as we knew for three days. Miraculously, Randall had no broken bones, only some abrasions. Currently, he's doing fine. Standard poodles, they're great, they're smart, they're gentle, they're excellent watch dogs; I'd never have another breed. I'm now a standard poodle guy. Get one, you'll love him or her.

* * * *

I agree with Bill Bennett who wrote the book, "Where's the Outrage?" Where is it? If you or I went before a grand jury and perjured ourselves (I don't care what the subject was), the best we'd get is about 11 months in prison. Why is the public so enamoured of Clinton that they want to exonerate him, slap his wrist, merely censure him if that? I hate to say it, but I think it all has to do with prosperity. The public thinks, "The country is in good shape. This guy is President, and he's done a good job. So why should we upset the apple-cart? If we kick him out, the market may go down, and that means my stocks will go down. Leave him alone. Let's not mess with prosperity." **My opinion:** This attitude reflects very badly on the American public. It's as if they've sold their souls for prosperity. I think it's awful. And I also believe in karma. This whole episode, I'm afraid, will not end well. In the end, the country will suffer for selling its soul. I really believe that.

"The good man often dreams about what the criminal does." But there's a huge difference. We're not responsible for our thoughts or our feelings. We are definitely responsible for our actions. When we do something immoral, if we are not sociopaths, we suffer guilt. Guilt eats on one's guts. There are three ways of

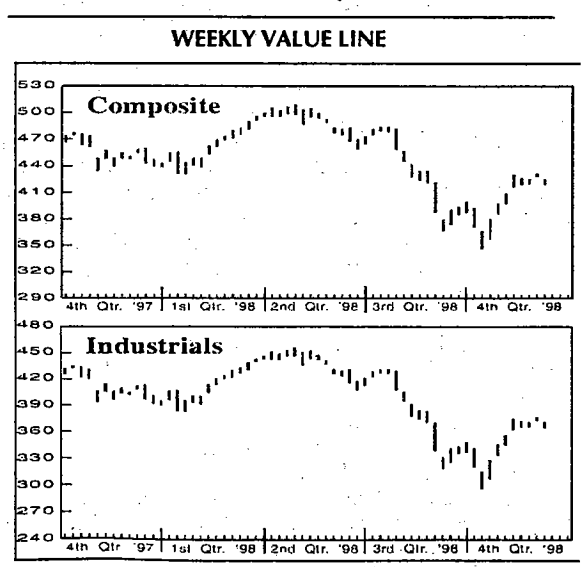
easing or even erasing guilt. One is to confess to another. A second way is to get sick. And a third way is to hurt oneself (fall off a bike or get into a fight and get hurt). The best way to ease guilt is to face what we've done, talk about it, confess, apologize to the one we've hurt. The criminal never takes the guilt upon himself, he thrusts it on someone else. Or he moves into a state of denial. "I didn't really do it." Or, "Everybody else does it, so what's the big deal", or, "You forced me or seduced me into doing it."

* * *

I've been working on a **web site** for the past few months. It may be a few months more. I want my subscribers to be able to get on the site and receive the daily PTI figures along with my comments regarding the position of the market plus anything else that comes to my mind. Of course, only subscribers will have access to the web site.

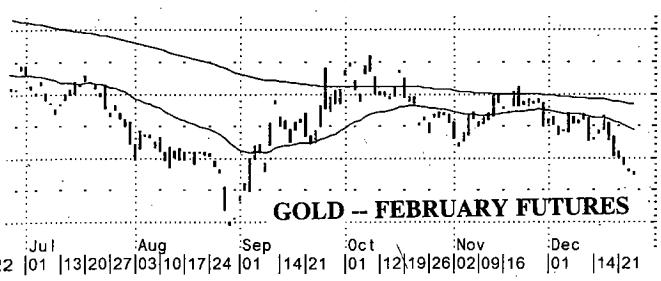
* * *

Value Line runs broad (geometric) averages which many believe represent one of the best, if not the best, measure of the broad price level of stocks. I show the Value Line Composite Average and the Value Line Industrial Average below (both weekly). You can see that neither of these two have even approached the highs of April. Further evidence of the narrowness of the October through December bear market rally.



GOLD: Sorry, I just don't have any good news here. The chart of the Feb. gold futures shows that the low for this contract was hit on August 28 at an extreme intra-day low of 277.50. Gold then rallied to an intra-day high of 307.70 on October 2. From there it's been all downhill.

The moving averages here tell the story. The 34-day MA never moved up over the 144-day MA, not a good sign. Then in late-November the 34-day MA dropped below the 144-day MA, and the futures sank below the 34-day MA -- which constitutes my "sell signal." On December 16 gold started down again, and it is now within shooting distance of its extreme August 28 low of 277.50 (remember, I'm still talking about the Feb. contract). Best hope -- that gold will continue to hold above the August 28 low, and that a "double bottom" will have formed.



It's increasingly clear that investors, instead of opting for gold as the ultimate safety, are simply switching from weak currencies to stronger currencies. It will be fascinating and most instructive to see what happens when the euro comes into being on January 1. Will the euro be the new "strong currency?" Will the dollar remain strong?

LATE COMMENT AND NOTES: There may be some confusion regarding what the Dow Theory is saying and what my PTI is saying. I'll try and clarify.

The Dow Theory has to do with the **big picture** -- the overall, long-term direction of the primary trend of the market. When the primary trend turns up or down, the market may not respond quickly and the market action may be very confused.

Let's take the vicious 1937 to 1942 bear market as an example. The Dow hit a high of 194 in March of '37 with the Transports at 64. Both Averages then declined to June -- but by August the Dow had climbed back to 190, only 4 points under its previous high. The two Averages then turned down again, and in late-August both Averages broke below previous lows. A Dow Theory bear market was signaled, and the market headed sharply lower. By November the Dow had crashed to 113, having lost a shocking 42% in a period of only eight months.

Reviewing the situation, it was seen that the last confirmed high in the Averages (the time when the two Averages hit their last highs **together**) was back on March 10. That was actually when The bear market began, but the fact that a bear market was in force **was not seen (or felt) until September, 1937**.

From the end of 1937 to early 1942 the stock market went through a complicated and totally puzzling series of gyrations. On April 28, 1942 (during World War II), the Dow hit its famous 92.92 low, a low that was never again broken.

Throughout the whole 1937 to 1942 period the primary trend of the market was down -- a bear market was in force. But if the PTI had been used, we would have seen the PTI rise and fall ("buy" and "sell" signals) many times, each one a valid trading signal. These buy and sell signals, however, would have all come **within the context of a major and very costly bear market.**

Thus, the conservative and patient investor who was guided by the Dow Theory would have stayed out of the market all during 1937 to 1942. In contrast, the trader who was guided by the PTI might have been in and out of the market four or five times.

By the same token, I consider that a bear market started on April 16, 1998. If you are the owner of a broad portfolio of stocks, you probably noticed that you have not done well, despite new highs in the S&P 500 and the Nasdaq. However, if you were smart enough or lucky enough to own Internet stocks, you are probably convinced that we are still in a major bull market.

LATE, LATE: I've stated that I expect the market to hold together through the seasonally bullish month of December with the trouble starting during January. Yet I haven't been impressed with the December action. Despite the near-crazed action of the Internet stocks, the action of the rest of the market has been sloppy with breadth shockingly poor. Remember, the A-D traces the direction of the **majority** of stocks on the NYSE. The A-D hit its most recent peak back on November 6. The A-D is telling us that since November 6 the direction of the majority of stocks on the NYSE has been **down.** This sets up the technical background for a "January surprise." If breadth continues down in January -- watch out!

By the way, my old friend Joe Granville, who has been bullish all through the rally, has now turned super-cautious to bearish based on his volume studies. When Joe is sharp, there's nobody in this business who's sharper. Now that Joe's studies have finally turned cautious to near-bearish, I suggest you do the same.

NEXT MAILING: Jan. 13, 1999